We Are on the Bell Lap:
Top 5 Takeaways from the IPCC's New Climate Science Report

by Alyson Slater, Senior Director, Sustainable Finance, Global Risk Institute

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On the close of the Tokyo 2020 Olympics, we now turn our attention to another race in which the bell is loudly tolling to say that we have come to the final lap. Today's release of the United Nations Intergovernmental Panel on Climate Change (IPCC) report shows that greenhouse gas emissions by humans has already caused the Earth to warm 1.1 degrees Celsius above pre-industrial temperatures, and will likely hit 1.5 degrees Celsius by 2040 if we continue on the current trajectory, a decade sooner than previously thought, and with catastrophic impacts. The sobering reading has been compiled by over 200 scientists and is supported by 14,000 research papers in what could be the most extensive research collaboration ever conducted. Results clearly point to a narrowing of the path that can be taken to stabilize the planet's climate. Coordinated global action across all fronts is urgently needed in the immediate term.

Canadian financial institutions provide capital and leverage to the country's societal and economic activity. Accordingly, they must play their part in managing and mitigating climate risk and accelerating low carbon opportunities. The following are five key takeaways from the IPCC report for financial institutions.

1. CANADA IS IN THE CROSS-HAIRS, AND THE WORLD AGREES

Modelled projections see a larger than average temperature increases for Canada due to its geographic location and other physical attributes. The report comes in a particularly catastrophic year in terms of storms, fires and droughts in Canada and will certainly accelerate the urgency for dramatic action to be taken to lower carbon emissions in the very short term.

The IPCC study is a powerful input to the 26th meeting of the Conference of the Parties (COP 26) in November of this year, not least because all United Nations member governments reached consensus that the study is accurate prior to its release. Alignment on the science ahead of COP 26 increases the expectation that countries will table far more ambitious Nationally Determined Contributions (NDCs) to reduce greenhouse gas emissions than in prior years, with the ultimate aim of reaching global net zero by 2050.

Canada has announced its NDC of cutting emissions by 40-45 per cent below 2005 levels in the next nine years to 2030, and reaching net zero by 2050, but has come under criticism for weak targets relative to major polluting economies such as the United States and the European Union, and lack of a clear action plan.

An increase in low carbon ambition from other countries will put the squeeze on the use of fossil fuels as a source of energy globally, and have major ramifications for the economy. For example, oil producing economies are facing pressure to eliminate fossil fuel subsidies and widen the base for carbon tax to speed the diversification of the energy sector, which in turn would increase credit risk for borrowers in the fossil fuels sector, and those with high emissions footprints, creating additional exposure for lenders.

2. CLEARER, DATA-DRIVEN FUTURE SCENARIOS ARE NOW POSSIBLE

Financial firms have long relied on IPCC data and scenarios for financial risk assessment drawn from an earlier version of this report, released ahead of the historic Paris Agreement in 2015. Recent scientific breakthroughs now bring more resolution to climate risk assessment, better data for climate risk scenario analysis, and updated set of IPCC net zero pathways. This data will support stress testing of portfolios under various scenarios, and could support the review of credit policies in the context of the refined IPCC scenarios.

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Scientists have narrowed the projections of the atmosphere's likely response to industrial emissions – so there is a clearer picture of what will happen if emissions are not cut to adequate levels, which will improve our ability to accurately price related risk. On the insurance side this could support better pricing, and could result in a possible increase in premiums or restricted access to insurance or re-insurance for some issuers and borrowers. There could also be an opportunity for new insurance product development as a result of access to better data.

Risk based capital allocation can be better defined and regulators are poised to respond. For example, the EU financial markets regulator is already considering additional capital requirements in response to climate risk.

3. LIABILITY RISK SET TO RISE AS HUMAN INFLUENCE ON THE CLIMATE IS NOW "UNEQUIVOCAL"

Amplified liability risk is expected owing to two major breakthrough findings in this report: Firstly, it can now be unequivocally concluded that the release of greenhouse gases by humans is causing climate change. Secondly, scientists are now also able to link specific weather events to human-made climate change, something that had evaded them over the past decades.

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This may open new fronts in climate liability risk by triggering firms to re-assess contracts which may have climate-related liability exposure. This field could follow a similar trajectory as the evolution of liability in the tobacco industry – more court cases and legal suits may arise for exposed industries, thereby having a knock-on effect for credit and market risk, and possibly direct legal risk for financial firms if they have financed known polluting industries that can be linked to damaging weather events.

4. DOUBLING DOWN ON TRANSITION FINANCE AND THE MOVE TO A LOW CARBON ECONOMY

With the central role of private finance in the upcoming COP 26 meeting, the spotlight will focus sharply on rapidly changing the financing and underwriting of fossil fuel emissions, and demand greater transparency from firms about net zero portfolio alignment and climate-related financial risk. Leading financial institutions globally have signed on to the Glasgow Financial Alliance for Net Zero (GFANZ), and the new IPCC report makes it harder for other firms to avoid. The GFANZ recognizes that it will take a whole-of-economy transition to achieve net zero emissions and that every company, bank, insurer and investor will have to adjust their business models, develop credible plans for the transition and implement them.

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The report provides a clearer picture of the benefits of cutting emissions, such as reduced floods, fires, droughts, and there are numerous upsides for firms to capitalize on. This will help clarify transition opportunity for financial firms, and give a boost to an already booming sustainable finance sector for products such as green bonds and sustainability-linked loans.

5. INVESTMENT IN THE ONE ENTITY THAT CAN SOFTEN THE BLOW: MOTHER EARTH

The new study presents a clearer picture of climatic processes that are now irreversible and worsening in an accelerating positive feedback loop, such as sea level rise and ice shield melts. Such impacts will not be halted even if we cut greenhouse gas emissions entirely today. This new degree of certainty will help financial firms understand what their clients and issuers are facing in the long-term, and the risks that can no longer be avoided. These insights will drive increased demand for financing of adaptation, resilience, and nature-based solutions to protect or change existing at-risk infrastructure. Retrofitting, for example, is expected to become a greater proportion of the sustainable finance market. Insurers, lenders and investors can now better understand the longer-term outlook for physical assets and infrastructure which can support better asset allocation, underwriting and pricing.

In sum, the new IPCC report provides an urgent call to action to policymakers to move forward with concrete plans to reduce greenhouse gas emissions. Time is of the essence for financial sector firms to prepare for a low carbon future, deal with fast changing risks, and focus on the opportunities opening up to finance the economy of a greener tomorrow.

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GRI supports members in managing sustainable finance and climate risk through research, events and education programming. For more on GRI's sustainable finance and climate risk programs please visit the GRI website or contact Alyson Slater directly at aslater@globalriskinstitute.org.

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